

## CHAPTER 1

NONAPPROPRIATED FUND ACCOUNTING0101 FUNDS010101 Nonappropriated Funds.

Nonappropriated funds (NAF) are monies which are not appropriated by the Congress of the United States. NAF come primarily from the sale of goods and services to Department of Defense (DoD) military and civilian personnel and their family members, and are used to support Morale, Welfare, and Recreation (MWR), and billeting, certain religious and educational programs. NAFs are government funds; they are used for the collective benefit of military personnel, their family members, and authorized civilians. These funds are separate and apart from funds that are recorded in the books of the US Treasury.

010102 Appropriated Funds. Appropriated funds (APF) are monies made available to DoD by Congress. Appropriations are generally of two types: annual and multi-year. The appropriation acts approved by Congress specify the purpose for which the APFs can be used. Accounting for APFs is significantly different than accounting for NAFs. Specific accounting policies and procedures for APFs are described in other volumes of the DoD Financial Management Regulation.

0102 ACCOUNTING

010201 Definition. Accounting is the art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial nature, and interpreting the results thereof. The primary use of accounting information is to aid decision-makers.

A. Recording. Recording of business transactions in an accurate and prompt manner is an essential requirement of both manual and automated accounting systems.

B. Classifying. Classifying relates to the process of sorting or grouping like things together rather than merely keeping a simple, diary-like narrative record of numerous and varied transactions and events. Ledgers are used to classify the journal entries according to like events.

1. General Ledger. The general ledger is the core of the NAF accounting system and provides a list of all accounting entries for the current period. A separate general ledger is established for each NAFI. All NAF accounting systems will use the chart of accounts in the appropriate Service supplement. At the end of each month, prepare a trial balance listing the balances in the general ledger accounts. Annually close the income and expense accounts to Fund Equity.

2. Subsidiary Records. NAF accounting systems have subsidiary records. If the number of transactions for a particular general ledger account is small or if balances are reversed at the beginning of each month or if the required data is maintained on a computer, a formal subsidiary ledger is not required. In some cases, a simple file system or the equivalent will be adequate provided it substantiates the general ledger account balance. Some typical subsidiary ledgers are:

a. Accounts Payable. Under a voucher system, a tickler or suspense file of unpaid vouchers can serve as the accounts payable subsidiary file. At the end of each month reconcile the total of all unpaid vouchers in this file to the general ledger control account.

b. Prepaid Accounts. Maintain a subsidiary record to aid proration of expenses for prepaid supplies, maintenance, insurance, etc. Reconcile any unexpired or unused amounts to the applicable general ledger control account.

c. Accounts Receivable.

Subsidiary records for receivables are of vital importance in the accounting system. Maintain detailed records so that it is possible to accurately identify the debtor and the amount of the debt. For example, the same subsidiary record may be used to maintain accounts receivable for a member and unamortized advance dues.

C. Summarizing. Summarizing is the process of bringing together financial information to develop financial statements or reports. The balance sheet, income statement and statement of cash flows are the most commonly used financial statements. The balance sheet provides information about the financial condition of a business at a certain point in time. The income statement provides information about the results of operation (i.e., profit or loss) for the accounting period. The statement of cash flows reflects the amount of net cash provided or used by a business during the period from (a) operating activities, (b) investing activities, and (c) financing activities.

D. Interpreting. Interpreting refers to the steps taken to direct attention to the significance of various matters and relationships. Percentage analyses and ratios are often used to help explain the meaning of related information.

010202 Accounting Information. Accounting information is useful when it is timely, relevant, reliable, cost beneficial, material, comparable, and consistent. These qualities are described as follows:

A. Timeliness. Timeliness refers to the prompt reporting of financial information to its users when it will be of maximum benefit. Financial data should be recorded as soon as practical after the occurrence of a transaction.

B. Relevance. Relevance is the capacity of information to make a difference in a decision by helping users to form predictions about the outcome of past, present, and future events or to confirm or correct prior expectations.

C. Reliability. Reliability is the quality of information that assures that is reasonably free from error and bias and faithfully represents what it purports to represent.

D. Cost Beneficial. Cost beneficial refers to measuring the expense of obtaining certain information against the benefits of having the information. Information should not be provided if the cost exceeds the benefits derived, unless it is required to meet legal or other specific purposes.

E. Materiality. Materiality refers to whether the information is significant enough to make a difference to a reasonable person relying on the information. A decision not to disclose information in the financial statements may be made because the amounts involved are too small to make a difference or to affect the reliability of the information. In addition to magnitude, the nature of the item must be considered when making a materiality judgement. Any information which is material will be reported in financial statements.

F. Comparable. Comparability relates to the similarity and consistency of information produced by an entity from period to period and by others operating in similar circumstances. The value and usefulness of information depends greatly on the degree to which it is comparable to information from prior periods and to similar information reported by others.

G. Consistent. Consistency pertains primarily to information produced by one accounting entity using essentially the same methods over a period of time.

010203 Generally Accepted Accounting Principles. The phrase "generally accepted accounting principles" (GAAP) is a technical accounting term which encompasses the conventions, rules, and procedures necessary to define accepted accounting practice at a particular time. It includes not only broad guidelines of general application, but also detailed practices and procedures. Those

conventions, rules, and procedures provide a standard by which to measure financial presentations.

A. Judgement. Although there are numerous sources of GAAP, some judgement may be necessary to determine whether:

1. The accounting principles selected and applied have general acceptance.

2. The accounting principles are appropriate in the circumstances.

3. The financial statements, including the related notes, are informative of matters that may affect their use, understanding and interpretation.

4. The information presented in the financial statements is classified and summarized in a reasonable manner, that is, it is neither too detailed nor too condensed.

5. The financial statements reflect the underlying transactions and events in a manner that presents the financial position, results of operations, and cash flows stated within a range of acceptable limits, that is, limits that are reasonable and practicable to attain in financial statements.

B. GAAP Hierarchy. A GAAP hierarchy has been established which identifies five categories or sources of GAAP (in descending order of importance):

1. Officially established accounting principles which consist of Financial Accounting Standards Board (FASB) Statements of Financial Accounting Standards and Interpretations, Accounting Principles Board (APB) Opinions, and American Institute of Certified Public Accountants (AICPA) Accounting Research Bulletins.

2. FASB Technical Bulletins and, if cleared by the FASB, AICPA Industry Audit and Accounting Guides and AICPA Statements of Position.

3. AICPA Accounting Standards Executive Committee (AcSEC) that have been cleared by the FASB and consensus positions of the FASB Emerging Issues Task Force.

4. AICPA accounting interpretations and implementation guides ("Qs and As") published by the FASB staff, and practices that are widely recognized and prevalent either generally or in the industry.

5. Other accounting literature, including FASB Concepts Statements; AICPA Issues Papers; International Accounting Standards Committee Statements; Government Accounting Standards Board (GASB) Statements, Interpretations, and Technical Bulletins; pronouncements of other professional associations or regulatory agencies; AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles.

C. Other Considerations. An important aspect of GAAP as applied to Government entities is the recognition of the variety of legal and contractual considerations typical of the Government environment. These considerations underlie and are reflected in the fund structure, bases of accounting, and other principles, and are a major factor distinguishing governmental accounting from commercial accounting. The following are some of the types of laws and regulations that may have a direct and material effect on the determination of amounts in a NAF activity's financial statements:

1. Requirements for reporting to DoD, Congress, and others.

2. Restrictions on use of appropriated funds.

3. Restrictions on expenditures, including expenditures for construction.

4. Restrictions on investments.

5. Laws and regulations for

NAF, Civil Service, and military personnel.

0103 ACCOUNTING METHODS.

010301 Accrual Basis. Most NAF organizations will use the double-entry accrual basis of accounting. This system is widely used in the commercial or private sector. The general theory of the double entry accounting system is that whenever any financial transaction or value change takes place, there are two accounting actions involved. These two actions are expressed as debits and credits. In accordance with established principles of double entry accounting, equilibrium must be maintained. Every recording of an entry must consist of a debit and an offsetting credit and the total dollar amount of debits must always equal the total dollar amount of credits. Under accrual accounting, transactions and other economic events are recorded when they occur. Revenues are recognized and reported when they are earned. Expenses are recognized and reported when they occur and are deducted from revenue to determine income. Accrual accounting emphasizes matching revenues and expenses associated with each other in the period in which they occur. Generally, accrual accounting contributes to effective financial control over resources, cost of operations and is essential in developing adequate revenue and cost information.

010302 Cash Basis of Accounting. Under the cash basis, revenue is recognized when cash is received from the customer or client, and expenses are recognized when cash is actually paid for the item or service received. Chapter 10 contains the specific policies and procedures for small NAF organizations authorized by their DoD Component to use the cash basis of accounting.

0104 ACCOUNTING PERIOD. The accounting period for DoD NAF organizations (except the Exchange Services) as set by DoD instruction 7000.12 begins October 1 of each year and ends September 30 of the next year. Exceptions must be approved in writing by the DoD Comptroller.

0105 THE ACCOUNTING CYCLE. The interim accounting period will be monthly.

0106 ACCOUNTING OFFICE (AO). The NAF AO provides centralized professional accounting services to NAF organizations. All DAOs will follow certain basic standards:

A. Maintain all books of original entry, the general ledger, and related subsidiary ledgers.

B. Maintain fixed asset records.

C. Prepare all disbursement vouchers and checks after assuring availability of funds and pays liabilities of all serviced NAF organizations.

D. Maintain payroll records when needed.

E. Prepare required periodic financial reports. The AO provides the NAF manager ratios and percentages as requested. The AO also provides variances in relation to established standards or approved budget goals upon request.

F. Prepare other information when requested by NAF management or higher authority. For example, the AO may provide technical advice on preparation of NAF budgets.

G. Prepare and distribute financial reports to all serviced NAF organizations.

H. Prepare an annual operating budget for the AO. If more than one NAF organization is serviced by the AO, then a schedule will be prepared that shows the estimated amounts to be assessed each serviced NAF organization.

I. Where applicable reconcile the bank accounts of serviced NAF organizations. Review daily account balances shown on monthly bank statements to ensure that insurance and collateral are sufficient. Notify NAF managers of missing or delayed deposit or check documentation.

J. Compute and bill the cost of operating the AO for each NAF organization serviced.

K. Review documentation for completeness and accuracy.

L. As required, provide documentation to independent auditors.

0107 ACCOUNTING OFFICE FUNDING. The AO will charge a service fee to all NAF organizations serviced to recover its operating costs.

0108 EXTERNAL ORGANIZATIONAL RELATIONSHIPS. AO personnel should be alert for changes in NAF organization cost centers and other changes so that proper accountability can be maintained.

0109 MORALE, WELFARE, AND RECREATION (MWR) CATEGORIES. In accordance with DoD Instruction 1015.1, MWR programs within the DoD have been classified into three basic categories for funding, financial reporting and program management. Each category has specific restrictions and requirements concerning funding. APF and NAF resources may be used only where permitted by DoD Directives 1015.4 and 1015.6.

0110 ACCOUNTING CHANGES. The term "accounting change" means a change in an accounting principle or a change in an accounting estimate. The correction of an error in previously issued financial statements is not an accounting change.

011001 Change in Accounting Principle. A change in accounting principle results from adoption of a generally accepted accounting principle different from the one used previously for reporting purposes. The term accounting principle includes not only accounting principles and practices but also the methods for applying them. A characteristic of a change in accounting principle is that it concerns a choice from among two or more generally accepted accounting principles. They include, for example, a change in the method of inventory pricing and a change in the depreciation method for previously

recorded assets. In the preparation of financial statements, there is a presumption that an accounting principle once adopted should not be changed in accounting for events and transactions of a similar type. Consistent use of accounting principles from one accounting period to another enhances the utility of financial statements to users by facilitating analysis and understanding of comparative accounting data.

011002 Change in Accounting Estimate. Changes in estimates used in accounting are necessary consequences of periodic presentations of financial statements. Preparing financial statements requires estimating the effects of future events. Examples of items for which estimates are necessary are uncollectible receivables, inventory obsolescence, and service lives and salvage values of fixed assets. Future events and their effects cannot be predicted with certainty; estimating, therefore, requires the exercise of judgement. Thus, accounting estimates change as new events occur, as more experience is acquired, or as additional information is obtained.

0111 ACCOUNTING ERRORS. Errors in financial statements result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared. In contrast, a change in accounting estimate results from new information or subsequent developments and accordingly from better insight or improved judgement. A change from an accounting principle that is not generally accepted to one that is generally accepted is a correction of an error.

0112 FUND EQUITY. Fund Equity consists of capital invested in the NAFI plus the profit or minus the loss resulting from operations since its inception. Transactions into and out of equity are limited to net income, net losses, and entries associated with the establishment, disestablishment, certain accounting principle changes, approved prior year error adjustments and distribution of capital. Fund equity adjustments should be very infrequent. When an item has been thoroughly

reviewed and it is determined the only appropriate treatment is to be recorded as an Equity Fund adjustment, a letter requesting approval to make a fund equity adjustment with all the facts surrounding the circumstances will be forwarded to DFAS via the appropriate program manager. Any request for Equity Fund Adjustment will be carefully reviewed by the program manager and DFAS prior to approval.

A. When a new NAF organization, with pre-existing capital, is authorized, that capital is recorded as equity, e.g., a private association that becomes a membership association. Equity is disestablished when a NAF organization is dissolved.

B. Equity may be distributed by declaring dividends to other NAF organizations. An example is dividends paid by base restaurants. Special grants for new construction and facility improvements are another method of distributing equity. Equity may be transferred in the form of cash or other assets.

0113 EXTRAORDINARY ITEMS. Extraordinary items are events and transactions that are distinguished by their unusual nature and by the infrequency of their occurrence. Both of the following criteria must be met to classify an event or transaction as an extraordinary item.

011301 Unusual Nature. The underlying event or transaction possesses a high degree of abnormality and is of a type clearly unrelated to, or only incidentally related to, the ordinary and typical operations of the NAFI, taking into account the environment in which the NAFI operates.

011302 Infrequency of Occurrence. The underlying event or transaction is of a type that would not reasonably be expected to recur in the foreseeable future, taking into account the environment in which the activity operates.

011303 Disclosure. Show extraordinary items separately as an item affecting net income after operating income.

0114 ETHICS To ensure that every

citizen can have complete confidence in the integrity of the Federal Government, each Federal employee (appropriated fund and nonappropriated fund) shall respect and adhere to the fundamental principles of ethical service. The provisions of DoD Directive 5500.7 and DoD Regulation 5500.7-R apply.

A. Public service is a public trust, requiring employees to place loyalty to the Constitution, the laws, and ethical principles above private gain.

B. Employees shall not hold financial interests that conflict with the conscientious performance of duty.

C. Employees shall not engage in financial transactions using nonpublic Government information or allow the improper use of such information to further any private interest.

D. An employee shall not, except pursuant to such reasonable exceptions as provided by regulation, solicit or accept any gift or other item of monetary value from any person or entity seeking official action from, doing business with, or conducting activities regulated by the employee's agency, or whose interests may be substantially affected by the performance or nonperformance of the employee's duties.

E. Employees shall put forth honest effort in the performance of their duties.

F. Employees shall make no unauthorized commitments or promises of any kind purporting to bind the Government.

G. Employees shall not use public office for private gain.

H. Employees shall act impartially and not give preferential treatment to any private organization or individual.

I. Employees shall protect and conserve Federal property and shall not use it for other than authorized activities.

J. Employees shall not engage in outside employment or activities, including seeking or negotiating for employment, that conflict with official Government duties and responsibilities.

K. Employees shall disclose waste, fraud, abuse, and corruption to appropriate authorities.

L. Employees shall satisfy in good faith their obligations as citizens, including all just financial obligations, especially those--such as Federal, State or local taxes--that are imposed by law.

M. Employees shall adhere to all laws and regulations that provide equal opportunity for all Americans regardless of race, color, religion, sex, national origin, age, or handicap.

N. Employees shall endeavor to avoid any actions creating the appearance that they are violating the law or these ethical standards.